

REPORT OF EXAMINATION
MSC LIFE INSURANCE COMPANY

Mountlake Terrace, Washington

December 31, 2002




States Participating:

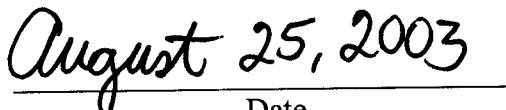
Washington

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that the attached Report of Examination shows the financial condition and affairs of **MSC LIFE INSURANCE COMPANY** of Mountlake Terrace, Washington as of December 31, 2002.



PATRICK H. MCNAUGHTON
Chief Examiner



Date

MSC LIFE INSURANCE COMPANY

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MSC LIFE INSURANCE COMPANY

SALUTATION

Seattle, Washington
August 25, 2003

The Honorable Mike Kreidler
Commissioner, State of Washington
PO Box 40255
Olympia, WA 98504-0255

Dear Commissioner Kreidler:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an examination has been made of the corporate affairs and financial records of

MSC LIFE INSURANCE COMPANY
of
Mountlake Terrace, Washington

hereinafter referred to as the "Company" or "MSCL", at its home office, located at 7001 220th Street, SW, Mountlake Terrace, Washington 98043-2124.

This report of examination is respectfully submitted showing the condition of the Company as of December 31, 2002.

MSC LIFE INSURANCE COMPANY

SCOPE OF EXAMINATION

As required by RCW 48.03.010, this examination covered the six-year period from January 1, 1997 through December 31, 2002. The examination was conducted at the Mountlake Terrace Home Office of the Company by examiners from the state of Washington. It was conducted in accordance with statutory requirements contained in the Washington Insurance Code and the guidelines recommended in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiner's Handbook. The Company's operating procedures and financial records were reviewed as considered necessary to ascertain the financial condition of the Company and conformity with the related laws. These matters are discussed in this report. In addition, the examination included identification and disposition of material transactions and events occurring subsequent to December 31, 2002 that were noted during this examination.

The prior examination covered the period from January 1, 1992 to December 31, 1996, and was conducted by insurance examiners from Washington.

INSTRUCTIONS

1. Approval of Investment Transactions

RCW 48.13.350 requires a written authorization record for each investment, in permanent form, signed by an officer of the insurer or by the chairman of a committee authorizing the investment. MSCL was instructed to comply with RCW 48.13.350 in the previous examination and provided assurance of compliance to the Washington State Office of Insurance Commissioner (OIC) in a letter dated January 13, 1999, stating:

"The Company has instituted a process such that an officer of the Company signs an authorization form for each investment transaction. These signed forms are retained in the Company's files as permanent written record of authorization."

To test the Company's assertion, we requested, but were unable to obtain, evidence that this policy had been implemented.

Under existing procedures, Blackrock Financial Management, Inc., a third party investment manager, makes trades based on guidelines provided by the Company. The Company Portfolio Manager, who is an employee but not an officer of the Company, reviews the monthly custodial statements for compliance with stated guidelines, but does not sign them. The Board of Directors minutes indicate that investment transactions were accepted or ratified in 1997, 1999, 2001 and 2002, the last time covering all transactions for the previous fifteen and a half months.

MSCL is again instructed to create an appropriate, written and permanent authorization record for each investment, signed by the appropriate individual, in compliance with RCW 48.13.350.

The Company has responded that it will comply with this instruction.

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2. Records and Accounts

Records supporting the calculation for amortization of bond premiums and discounts were not provided as requested. Without records regarding prepayment assumptions and the retrospective-adjustment method, the examination team was unable to validate the amortization of premiums or accretion of discounts for the loan-backed bonds listed in Schedule D – Part 1. Therefore, the examiners were forced to approximate the accuracy of the reported data. These securities represent 48% of MSCL's long-term bond portfolio and thus, are an essential component of this examination.

The Company is instructed to maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D and is instructed to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner.

Subsequent to the examination, the Company succeeded in devising a methodology for verifying the amortization calculations. It now remains only to establish a policy for verifying such calculations on a regular, systematic basis.

3. Intercompany Agreements

The Company is not a signer on either of the current intercompany expense reimbursement and tax sharing agreements. Also, RCW 48.31B.030(1)(b)(iv) requires that all management agreements with members of the Company's holding company system be submitted in writing for acceptance or approval by the OIC. The Company responded that there are agreements signed by the parent companies in the Premera organization which were filed with the OIC. However, this does not satisfy the requirement that expense reimbursement and tax-sharing agreements between the Company and its holding company affiliates be appropriately executed and filed with the Commissioner.

The Company is instructed to formally draft an intercompany agreement with Premera and/or Premera Blue Cross describing services rendered and the reimbursement methodology for those services. The Company is also instructed to revise or amend the Restated Intercompany Tax Sharing Agreement so that the Company is a signer to both agreements. In addition, the Company is instructed to submit the contract to the OIC before its execution, per RCW 48.31B.030 (1)(b)(iv).

4. Conflict of Interest

Upon requesting a copy of the Company's Conflict of Interest Policy, Premera's policy was furnished. That policy requires that conflict of interest questionnaires be completed annually and that the results be reported to the Board at the annual Board Meeting. However, there was no such report to the Board for 1997, 1998 or 2000. The Company responded that the Holding

MSC LIFE INSURANCE COMPANY

Company's policy was to only notify the parent companies' Board concerning reportable items, not the MSC Life Board. However, the statutes are written from an individual company perspective and each individual company is considered to be a stand-alone entity. Therefore, reporting to another company's Board, even if it is the parent company, does not satisfy the individual reporting requirements of the insurer, MSCL.

RCW 48.05.370 states, "Officers and directors of an insurer... shall be deemed to stand in a fiduciary relation to the insurer, and shall discharge the duties of their respective positions in good faith, and with that diligence, care and skill which ordinary prudent men would exercise under similar circumstances in like positions." The Company is instructed to ensure that conflict of interest questionnaires are received from appropriate officials and reviewed, and that the results of the review be annually reported to the Board, as required by the Conflict of Interest Policy.

5. Annual Statement- Notes to Financial Statements

Note #12.E of the 2002 Annual Statement regarding Postemployment Benefits and Compensated Absences is required by the Annual Statement Instructions. However, this note was omitted from the Annual Statement filed by the Company.

WAC 284-07-050(2) requires Washington insurers to file an annual statement and adhere to the appropriate NAIC Annual Statement Instructions. In future filings, the Company is instructed to comply with the NAIC Annual Statement Instructions and to include all required disclosures.

Note #15.A of the 2002 Annual Statement states that "The Company does not participate in leasing arrangements." In fact, in 2002, the Company signed a lease incepting January 1, 2003, for office space in Scottsdale, Arizona.

In accordance with RCW 48.05.250, which requires annual filing of a "true statement of its financial condition, transactions and affairs...", the Company is instructed to correctly answer all questions in future filings.

The Company responded that in all future filings, it will comply with RCW 48.05.250 and WAC 284-07-050(2).

6. Board Approval of Tax Sharing Agreement

Note 9.F of the 2002 Annual Statement indicates the tax sharing agreement was approved by the Board of Directors. RCW 48.31B.030(1)(b)(iv) requires that the OIC be notified of such agreements. The Company could only provide support for the agreement being approved by the Board of the parent company (MSC of Eastern Washington). MSCL subsequently clarified that it was actually party to a "Subsidiary Tax Sharing Agreement", which would be approved by the MSCL Board in the future, since proof of prior approval could not be documented.

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In accordance with RCW 48.05.250, which requires the Company to file a “true statement of its financial condition, transactions, and affairs”, and RCW 48.31B.030(1)(b)(iv), the Company is instructed to have the applicable Tax-Sharing Agreement approved by the MSC Life Insurance Company Board of Directors and to notify the OIC prior to implementation.

7. Annual Statement Schedule Y, Part 2

MSCL was not included in Schedule Y, Part 2, which requires inclusion of a summary of the insurer’s transactions with any affiliates.

In accordance with NAIC Annual Statement Instructions, which require reporting of transactions between insurers and non-insurers within the holding company system, including those related to management agreements, service contracts and intercompany tax-sharing agreements, the Company is instructed to include its activity with affiliates in Annual Statement Schedule Y, Part 2.

The Company responded that it will comply with this instruction in future filings.

8. Shareholder Meetings

There is no record of an annual Shareholder meeting in 1998, as required by the Bylaws, Article 2, during the examination period, although the Company states that this does not mean such meeting did not occur.

The Company is instructed to hold a shareholders’ meeting, at least annually as required by RCW 48.07.040 which states, “Each incorporated domestic insurer shall hold an annual meeting of its shareholders... in accordance with its bylaws for the purpose of receiving reports of its affairs and to elect directors.”

The Company states that it will hold annual meetings in the future.

9. Number of Board Members

RCW 48.06.200(5), sixth provision, requires incorporated insurers to have a board with not less than 5 directors. The Articles of Incorporation and the Bylaws require a minimum of five Board members; in 1998 there were only four.

The Company is instructed to maintain five board members in compliance with RCW 48.06.200(5) and its Bylaws.

In order to avoid recurrence of this problem, the Company has responded that it intends to fill board vacancies as quickly as possible.

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COMMENTS AND RECOMMENDATIONS

1. Custodial Agreement

In the 2002 Annual Statement Interrogatory #22.01, the Company states that its Custodial Agreement with BNY Western Trust Company complies with the NAIC Financial Condition Examiner's Handbook. However, the Custodial Agreement is deficient concerning the notification of termination to the Insurance Commissioner and maintenance of adequate insurance protection.

The Company should revise its custodial agreement to comply with the NAIC Financial Condition Examiner's Handbook to:

- **Ensure that the custodial agreement contains a clause requiring the custodian to notify the commissioner if a custodial agreement is terminated or if all of the custody account's assets have been withdrawn (2003 NAIC Financial Condition Examiner's Handbook, Part 1 - General, IV. Conducting Examinations, Section J, Paragraph 2.f.).**
- **Ensure that the custodial agreement contains a clause requiring the custodian to maintain adequate insurance protection for its custodial assets (NAIC Financial Condition Examiner's Handbook, Part 1 - General, IV. Conducting Examinations, Section J, Paragraph 2.k.).**

The Company has responded that it will amend its custodial agreement to correct the above deficiencies.

2. Authorized Stock

The 2001 audit report issued by Ernst & Young states that there are 400,000 authorized shares of common stock. Article 4 of the Company's Articles of Incorporation and the Company's Annual Statement state that there are 325,000 shares of common stock authorized and 75,000 shares of preferred stock authorized.

The auditor's report is intended to reflect Company representations from the annual statement filed with the state. Therefore, it is recommended that the Company advise its independent auditors of this discrepancy.

The Company has responded that it has advised its independent auditors of this discrepancy.

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3. Board Meetings

The Company has not held quarterly board meetings as required by the Bylaws, Article 3.7. There is no record of any Board of Directors' meetings during 1998.

Since Article 3.7 of the Bylaws requires regular meetings at least quarterly, it is recommended that the Company hold quarterly meetings of the Board of Directors or amend its Bylaws.

The Company has responded that it will amend its Bylaws to eliminate the requirement for quarterly meetings.

HISTORY

MSC Life Insurance Company (MSCL) is a Washington-domiciled life and disability insurer that specializes in providing group accident & health stop-loss coverage for self-insured groups administered by its parent, Premera BlueCross (PBC). MSCL is authorized to do business only in Washington State. MSCL was incorporated on June 1, 1992 by its then-parent company, Medical Service Corporation of Eastern Washington (MSC). Historically, MSC maintained a strong local presence as a Blue Shield Plan with operations in the Spokane, Washington area.

In order to strengthen its state-wide presence, Blue Cross of Washington and Alaska (BCWA) formed an affiliation with MSC in November 1994 through the formation of Premera, a new Washington non-profit corporation. Premera is the Parent of PBC and the ultimate parent of MSCL.

On June 30 1998, BCWA and MSC merged. BCWA remained as the surviving legal entity. Simultaneously with the merger, BCWA adopted its present name, Premera BlueCross.

PBC is a non-profit corporation that provides basic medical, hospital, major medical, comprehensive, and other prepaid health care benefits for its subscribers. PBC is a member of the Blue Cross and Blue Shield Association and is licensed as a health care service contractor in the states of Washington and Alaska. PBC is controlled by Premera, an upstream holding company that is the sole voting member.

In 2001, upon contract expiration, States West Life Insurance Company, a sister company, began renewing the MSCL business. As a result, net writings dropped from \$1,121,907 in 2000 to \$169,410 in 2001 and \$1,561 in 2002. As of year-end 2002, the Company had no policies in force and no loss reserves.

Prior to 2001, MSCL invested primarily in long-term securities that were rated as investment quality. During 2001, the Company changed its investment strategy to invest only in bonds and short-term investments, i.e., the Company no longer holds equity investments.

MSC LIFE INSURANCE COMPANY

MANAGEMENT

Board of Directors

The Bylaws vest all corporate powers and control of the Company's business affairs in a five-member Board of Directors. Not less than three-fourths of the Board of Directors shall be United States citizens, as required by RCW 48.07.050. Directors of the Company need not be citizens of the state of Washington or shareholders of the corporation.

The Company's operations are under the control of its President, Clifford Warren Klima, who was hired in 2002 to replace Stephen Melton. Mr. Klima has been working in the insurance industry in Arizona since 1981. He came to MSCL from Aetna US Healthcare where he was general manager. Prior to that, he was CEO of FHP of Arizona, Inc. (now PacifiCare) and Vice President of Finance for Lincoln Health Resources.

Directors and Officers serving the Company as of **December 31, 2002**, were as follows:

Officers:

<u>Name</u>	<u>Title</u>
H. R. Brereton Barlow	Chairman of the Board
Clifford Warren Klima	President and Chief Executive Officer
Audrey Halvorson	Senior Vice President, Actuarial Services and Chief Actuary
Sharilyn Ann Campbell	Vice President, Finance and Treasurer
John Peter Domeika	Senior Vice President, General Counsel and Corporate Secretary

Directors:

<u>Name</u>	<u>Principle Occupation</u>
Brian Eugene Ancell	Executive Vice President, Strategic Development and Health Care Services, Premera BlueCross
Herbert Randle Brereton Barlow	President and Chief Executive Officer Premera BlueCross
Clifford Warren Klima	President, MSCL
Kent Steven Marquardt	EVP & CFO, Premera BlueCross
Steven Dale Melton	Past President, MSCL Life, VP Premera BlueCross

Committees as of December 31, 2002

There were no committees during the period covered by this examination.

MSC LIFE INSURANCE COMPANY

AFFILIATED COMPANIES

MSCL is a wholly - owned subsidiary of **Premera BlueCross (PBC)**, with the ultimate parent being **Premera**. PBC and Premera are Washington Nonprofit Corporations.

As a member of a holding company system, holding company statements are required to be filed under RCW 48.31B.025(1) and chapter 284-18 WAC. These statements have been filed by MSCL for each of the years under examination.

PBC also owns 100% of the stock of **PremeraFirst, Inc.**, a corporation utilized primarily to act as an agent for contracting with providers and **Washington-Alaska Group Services, Inc.(WAGS)**, a corporation doing business as an insurance sales agency.

WAGS owns 100% of the stock of:

States West Life Insurance Company, a corporation authorized to transact life and disability insurance.

LifeWise Health Plan of Washington, a corporation authorized to transact the business of health care service contractor.

Quality Solutions, a corporation providing investigation and recovery services for health plans and self-funded employer benefit plans.

LifeWise Administrators, Inc., a corporation providing consolidated billing and collection services to affiliates.

NorthStar Administrators, Inc., a corporation doing business as a third-party administrator.

LifeWise Health Plan of Oregon, Inc. (LWOR), an insurance company authorized to transact the business of life and health insurance.

LWOR owns 100% of the stock of **Western Benefits Administrators, Inc.**, a corporation organized for the primary purpose of administering insurance claims for self-insured employers.

CORPORATE RECORDS

Minutes

The examiners reviewed the corporate records of MSCL for the period under examination. A quorum was present for all Board meetings. The Board ratified all changes to the Articles of Incorporation. On April 10, 2002, the board minutes noted 100% of stop loss business had been transferred to States West Life. The current officers were elected on April 10, 2002.

MSC LIFE INSURANCE COMPANY

During 2002, Articles 8 and 9 of the Revised Articles of Incorporation were deleted and replaced with a new Article 9, entitled "Limitation of Liability and Indemnification". The purpose of these revisions was to confine director liability to the extent permitted by the Washington Business Corporation Act.

Conflicts of Interest

MSC Life Insurance Company has a policy statement which requires all directors, officers and key employees to annually sign a questionnaire disclosing any conflicts of interest. Management reported to the Board of Directors that there were no conflicts of interest for 1999, 2001 and 2002. There was no report to the Board of the conflict of interest review for the years 1997, 1998 or 2000. See "Instructions" number 4.

Contracts

As of December 31, 2002, the Company was party to the following contracts:

Affiliates:	Effective Date
Intercompany Cost Allocation Agreement	11-21-1994
Restated Intercompany Tax Sharing Agreement	11-21-1994
Non-Affiliates:	
Investment Custody Agreement (with BNY Western Trust Company)	8-31-2000
Investment Advisor Agreement (with Blackrock Financial Management, Inc.)	7-13-1998

Capital Stock Register

MCSL has authorized 250,000 shares of Common A stock, 75,000 shares of Common B stock, and 75,000 shares of Preferred A Stock. All authorized shares have a par value of \$10 per share. Common A shares have dividend, voting and liquidation rights. The preferences, privileges, restrictions and rights of Common B and Preferred A shares are reserved for determination by the Board of Directors.

There are 240,000 shares of Common A stock outstanding, with a total par value of \$2,400,000. The total paid-in capital stock and surplus equaled \$9,534,588, exceeding the minimum requirements set forth in RCW 48.05.340. All outstanding shares are held by Premera BC.

OFFICERS AND EMPLOYEES WELFARE AND PENSION PLANS

The officers and directors of the Company are employees of other PREMERA Group of companies and accordingly are members of the Group welfare or pension plans.

MSC LIFE INSURANCE COMPANY

TERRITORY AND PLAN OF OPERATION

The Company was licensed to operate only in the state of Washington during the period being examined. The Company offers group stop-loss coverage to self-insured employer health plans administered by Premera BC, an upstream non-profit holding company. The Certificate of Authority was examined and found in order. The Company was current in the payment of premium taxes and filing fees.

INTERNAL SECURITY

External Audit Function

The firm of Ernst & Young LLP, Certified Public Accountants, audited the Company's statutory financial statements and issued unqualified opinions for the years 1997 – 2001. The Company was exempt from the CPA audit requirement for 2002 pursuant to WAC 284-07-100 (2), since it had less than one million dollars in premiums and less than one thousand policyholders.

Internal Audit Function

There is a corporation-wide internal audit function, though not one specifically for MSC Life Insurance Company. According to the Company, risk assessed for MSCL has always been low, so no internal audits have been performed. The internal audit department has performed some procedural review work at the request of the external auditors.

Physical Security Systems

Securities are kept with the custodian, BNY Western Trust Company. No securities are kept on site.

Fidelity Bonds and Other Insurance

The Company is a named insured on an extensive portfolio of insurance which provides coverage against catastrophic and other losses. All policies are annually renewable in October. The NAIC suggested minimum amount of fidelity insurance is \$100,000, while the Company carries \$10 million.

MSC LIFE INSURANCE COMPANY**PREMERA AND SUBSIDIARIES****INSURANCE SUMMARY****MAY 15, 2002**

COVERAGE	CARRIER	LIMIT (\$)	DEDUCTIBLE (\$)
Real & Personal Property -Combined Property including Extra Expense, Service Interruption Electronic Data Processing & Boiler & Machinery -Earthquake -Flood	Affiliated F.M. (AM Best: A+, XV)	160,000,000 100,000 per occurrence 75,000,000 75,000,000	100,000 per occurrence 5% of the combined value of the property 100,000 per occurrence
Commercial General Liability	Wausau (AM Best: A+, XV)	2,000,000 aggregate	\$1,000,000 per occurrence
Automobile Property & Liability	Wausau	1,000,000 occurrence	0
Umbrella/Excess Liability	Wausau	15,000,000 occurrence 15,000,000 aggregate	Excess of underlying coverage
Workers' Compensation (Employers Liab)	Wausau	500,000 each accident/each limit/each employee	0
Fidelity Crime Bond	Hartford Fire Insurance(AM Best: A+, XV)	10,000,000 aggregate 5,000,000 occurrence	100,000 per occurrence
Fiduciary Liability (Pension Trust)	Chubb(AM Best: A++, XV)	5,000,000 aggregate	5,000 per occurrence
Environmental Impairment Liability	Colony Insurance Co. (AM Best: A-, VI)	1,000,000 aggregate 1,000,000 occurrence	1,000 per occurrence
Directors & Officers Liability	ASLIC/AIG(AM Best: A++, XV) RLI(AM Best: A, IX)	30,000,000 aggregate* 20,000,000 aggregate	150,000 per occurrence
Corporate Professional Liability	ASLIC/AIG(AM Best: A++, XV) RLI(AM Best: A, IX)	30,000,000 aggregate* 20,000,000 aggregate	250,000 per occurrence

* Subject to a non-stacking clause for a single claim filed against both policies.

MSC LIFE INSURANCE COMPANY

FINANCIAL SUMMARY

All information was compiled from the Company's filed annual statements.

In June 1992, MSCL was capitalized by its then-parent MSC through the contribution of \$5.2 million. Surplus has steadily grown from \$4,587,303 at year-end 1996 to \$7,134,588 at December 31, 2002, while capital remained constant at \$2.4 million since inception.

Balance Sheets

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2002	\$10,598,130	\$1,063,542	\$9,534,588
2001	10,065,232	543,561	9,521,671
2000	9,411,837	1,009,657	8,402,180
1999	9,828,125	1,038,782	8,789,343
1998	8,869,559	719,927	8,149,632
1997	7,954,730	536,793	7,417,937

Income Statements

<u>Year</u>	<u>Net Premium Written*</u>	<u>Investment Income</u>	<u>Net Policy Benefits</u>	<u>General Expenses</u>
2002	\$1,561	\$480,468	**(\$156,834)	*** \$371,999
2001	169,410	490,226	**** (23,964)	41,574
2000	1,121,907	453,071	1,360,482	86,919
1999	1,069,178	350,625	465,664	61,989
1998	1,145,317	401,057	415,713	60,829
1997	855,774	455,456	663,043	34,991

*In 2001, upon contract expiration, States West Life Insurance Company, a sister company, began renewing the MSCL business. As a result, premium writings dropped from \$1,121,907 in 2000 to \$169,410 in 2001 and \$1,561 in 2002. As of year-end 2002, the Company had no policies in force and no loss reserves.

**In 2002, the Company recovered losses paid in a prior year because medical expenses for twins were erroneously coded to only one of the twins, resulting in the loss apparently exceeding the employer retention.

***The significant general expenses increase in 2002 was the result of startup expenses in Arizona. The Company was in the process of obtaining a license to do business in Arizona as of year-end 2002.

****In 2001, the Company released a prior year reserve that exceeded the amount of the actual settlement, resulting in negative losses for 2001.

MSC LIFE INSURANCE COMPANY

BUSINESS IN FORCE BY STATE

The Company recovered ceded premiums from the prior year resulting in net written premiums of \$1,561. There were no premiums in force at December 31, 2002.

REINSURANCE

The Company has a reinsurance treaty with Continental Assurance Co, Chicago, IL; the treaty provides the following coverage for group A&H business:

The Reinsurer accepts 100% of the Company's liability under any and all policies classified as Specific Stop loss (SSL) Medical coverage in excess of the first three hundred thousand (\$300,000) (inclusive of the employer's self -insured retention), up to a specific lifetime maximum of Two Million Dollars (\$2,000,000) per person.

The Company agrees to retain for its own account the first Three Hundred Thousand Dollars (\$300,000) (inclusive of the employer's self-insured retention) of its liability under the policies subject to the agreement.

ACCOUNTING RECORDS & ACTUARIAL OPINION

Accounting Records

The Company maintains its accounting records on a GAAP accrual basis of accounting and adjusts to a Statutory Accounting Practices (SAP) basis for Annual Statement reporting.

Actuarial Opinion

The Company is exempt pursuant to WAC 284-07-310 through 284-07-400 from submitting a statement of actuarial opinion based on an asset adequacy analysis. The statement of actuarial opinion provided by MSCL's Appointed Actuary is not based on an asset adequacy analysis and is in accordance with WAC 284-07-370.

SUBSEQUENT EVENTS

On March 18, 2003, after receiving approval from the OIC, the name of the Company was changed from MSC Life Insurance Company to LifeWise Health Plan of Arizona, Inc. A Certificate of Authority for Washington was then issued to LifeWise Health Plan of Arizona, Inc. Arizona has informed the OIC that the Company has applied for a license there and intends to change its state of domicile to Arizona, after getting the license. The Company has signed a sixty-six month lease for office space in Scottsdale, Arizona. The first six months are rent-free and monthly lease payments of \$18,128 begin July 1, 2003.

MSC LIFE INSURANCE COMPANY

During the first quarter of 2003, the Company recognized an additional \$281,500 charge to surplus for non-admitted assets, mainly attributable to increases in furniture and equipment and leasehold improvements in Arizona; and experienced a \$535,200 net loss, primarily driven by \$753,600 in general expenses with no premium revenue.

RECOMMENDATIONS FROM PREVIOUS EXAMINATION:

The examiners reviewed the Company's filed 1996 Annual Statement as part of the 1996 statutory examination. The review focused on determining if the Company's Annual Statement was completed in accordance with the NAIC Annual Statement Instructions. The following summarizes the exceptions noted while performing this review and the Company is instructed to correct and comply in future Annual Statement filings, per RCW 48.05.250.

Securities in Trust

The custodial agreement does not include the required provisions for indemnifying the Company for lost securities, and thus, does not conform to the standards set forth by the NAIC. The Company is instructed to revise its custodial agreements to comply with NAIC guidelines, RCW 48.05.250 and WAC 284-07-050.

Bonds

The examiners reviewed the supporting records pertaining to the 1996 bond acquisitions and noted that the Company does not maintain a written record in permanent form showing authorization by an officer of the Company of the acquisition of securities, as required by RCW 48.13.350. The Company is instructed to maintain a written record, in permanent form, showing authorization by an officer of the Company of the acquisition of securities, as required by RCW 48.13.350.

Intercompany Agreements

All management agreements with members of the Company's holding company system must be submitted in writing for approval by the OIC. The Company is instructed to formally draft an intercompany agreement with MSC Service Corporation describing services rendered and the reimbursement methodology for those services and file the contract with the OIC, per RCW 48.31B.030(1)(b)(iv).

MSC LIFE INSURANCE COMPANY

CURRENT REVIEW OF INSTRUCTIONS FROM PREVIOUS EXAMINATION:

Securities in Trust

Company Response January 13, 1999:

MSC Life Insurance Company and its custodian executed an addendum to the current custodial agreement that includes the required language indemnifying the Company for lost securities.

Examiner Comment:

The agreement was revised on August 31, 2000, but the revised custodial agreement does not include two required provisions relating to the termination of the agreement and maintenance of insurance protection by the custodian, as noted in Comments and Recommendations number 1 of this current report.

Bonds

Company Response January 13, 1999:

The Company has instituted a process such that an officer of the Company signs an authorization form for each investment transaction. These signed forms are retained in the Company's files as a permanent written record of authorization.

Examiner Comment:

See Instruction number 1 of this current report for comments relating to the above response.

MSCL uses the services of an outside investment management service, Blackrock Financial Management Inc., to purchase and sell investments in accordance with the Statement of Investment Policy, Objectives, and Guidelines for Premera. The custodian, BNY Western Trust Company, submits monthly statements to MSCL summarizing all investment activity as required by RCW 48.13.350. The statements are kept on file.

On a monthly basis, an Investment Accountant and a Portfolio Manager, non-officer employees of Premera, review these statements for compliance with the Company's guidelines, but do not sign them. The Board of Directors intermittently ratifies all investment transactions presented to them. See Instruction number 1 of this current report for additional comments.

Intercompany Agreements

Company Response January 13, 1998:

In reviewing a draft of the examination report, the Company informed the OIC that MSC Service Corporation does not perform services for the Company. The matter was revisited by the Examiner-in-Charge and the Deputy Insurance Commissioner. Based on the review of the Examiner-in-Charge, it was concluded that no intercompany agreement was necessary and this

MSC LIFE INSURANCE COMPANY

conclusion was documented by letter to the Deputy Insurance Commissioner, dated April 8, 1998.

FINANCIAL STATEMENTS

DECEMBER 31, 2002

The following pages report the financial condition of the Company. No adjustments were made by the examiners.

BALANCE SHEET

	Balance Per Company	Balance Per Examination
<u>ASSETS</u>		
Bonds	\$7,806,668	\$7,806,668
Cash	2,460,703	2,460,703
Subtotals, cash and invested assets	10,267,371	10,267,371
Electronic Data processing equipment and software	168,452	168,452
Federal and foreign income tax recoverable	62,296	62,296
Investment income due and accrued	94,745	94,745
Receivable from state taxing authorities	5,266	5,266
Total Assets	\$10,598,130	\$10,598,130
<u>LIABILITIES</u>		
Interest maintenance reserve	\$384,919	\$384,919
General expenses due or accrued	14,560	14,560
Taxes, licenses and fees due or accrued, excluding federal income taxes	75	75
Asset valuation reserve	14,202	14,202
Payable to parent, subsidiaries and affiliates	648,589	648,589
Unclaimed Property	1,197	1,197
Total Liabilities	1,063,542	1,063,542
<u>SURPLUS AND OTHER FUNDS</u>		
Common capital stock	2,400,000	2,400,000
Gross paid-in and contributed surplus	2,769,664	2,769,664
Unassigned funds (surplus)	4,364,924	4,364,924
Total Surplus	7,134,588	7,134,588
Total Surplus and Other Funds	9,534,588	9,534,588
Total Liabilities, Surplus and Other Funds	\$10,598,130	\$10,598,130

MSC LIFE INSURANCE COMPANY

SUMMARY OF OPERATIONS

For the Year Ended December 31, 2002

	Balance Per <u>Company</u>	Balance Per <u>Examination</u>
Premiums and annuity considerations	\$1,561	\$1,561
Net investment income	480,468	480,648
Amortization of interest maintenance reserve	65,366	65,366
Totals	<u>547,395</u>	<u>547,395</u>
Disability benefits and benefits under accident and health policies	(156,834)	(156,834)
General insurance expenses	371,999	371,999
Insurance taxes, licenses and fees, excluding federal income taxes	7,450	7,450
Totals	<u>222,615</u>	<u>222,615</u>
Net gain from operations	324,780	324,780
Federal income taxes incurred	72,267	72,267
Net Income	<u><u>\$252,513</u></u>	<u><u>\$252,513</u></u>

CAPITAL AND SURPLUS ACCOUNT

For the Year Ended December 31, 2002

	Balance Per <u>Company</u>	Balance Per <u>Examination</u>
Capital and surplus, December 31, prior year	\$9,521,671	\$9,521,671
Net income	252,513	252,513
Change in net deferred income tax	108,644	108,644
Change in nonadmitted assets and related items	(346,812)	(346,812)
Change in asset valuation reserve	(1,428)	(1,428)
Net change in capital and surplus for the year	<u>12,917</u>	<u>12,917</u>
Capital and surplus, December 31, current year	<u><u>\$9,534,588</u></u>	<u><u>\$9,534,588</u></u>

MSC LIFE INSURANCE COMPANY

FIVE-YEAR CAPITAL AND SURPLUS RECONCILIATION

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
<u>CAPITAL AND SURPLUS</u>						
<u>ACCOUNT</u>						
Capital and surplus, December 31, prior year	\$9,521,671	\$8,402,180	\$8,789,343	\$8,149,632	\$7,417,937	\$6,987,303
<u>GAINS AND (LOSSES) IN</u>						
<u>SURPLUS</u>						
Net income	252,513	371,545	40,825	828,660	826,379	429,477
Change in unrealized capital gains (losses)		24,367	(190,797)	212,343	(45,912)	
Change in deferred income tax	108,644	(25,726)				
Change in nonadmitted assets and related items	(346,812)	383,227	(330,889)	(52,338)	1,652	390
Change in asset valuation reserve	(1,428)	306,053	93,698	(348,954)	(50,424)	767
Cumulative effect of change in accounting principles		60,025				
Net change in capital and surplus for the year	12,917	1,119,491	(387,163)	639,711	731,695	430,634
Capital and surplus, December 31, current year	<u>\$9,534,588</u>	<u>\$9,521,671</u>	<u>\$8,402,180</u>	<u>\$8,789,343</u>	<u>\$8,149,632</u>	<u>\$7,417,937</u>

MSC LIFE INSURANCE COMPANY

NOTES TO FINANCIAL STATEMENTS

Bonds

Bonds not backed by other loans are reported at amortized cost. The discount or premium on bonds is amortized using the scientific method. Realized investment gains and losses are determined using the specific-identification method.

For loan-backed bonds, anticipated prepayments are considered when determining the amortization of discount or premium. Prepayment assumptions are consistent with the current interest rate and economic environment. The retrospective-adjustment method is used to value loan-backed bonds.

The Company's investment in bonds represented (73.7%) of its admitted assets. The bond portfolio consisted of the following:

<u>Classification</u>	<u>Statement Value</u>	<u>Par Value</u>	<u>Fair Value</u>
U.S. Government	\$6,413,703	\$5,924,794	\$6,936,655
Public Utilities	48,376	50,000	52,424
Industrial & Misc.	<u>1,344,589</u>	<u>1,349,635</u>	<u>1,400,083</u>
Total	\$7,806,668	\$7,324,429	\$8,389,162

Short Term Investments

Short-term investments include investments with remaining maturities of one year or less at the date of acquisition, excluding negotiable certificates of deposit. Negotiable certificates of deposit maturing within one year are classified as cash. Short-term investments are stated at amortized cost.

Valuation Reserves

An asset valuation reserve (AVR) is calculated using a formula prescribed by the NAIC. This reserve acts to mitigate the effects on unassigned surplus of fluctuations in the gains and losses on invested assets. Changes in the AVR are reflected directly in unassigned surplus. An interest maintenance reserve (IMR) is also provided that captures realized gains and losses resulting from the effect of changes in the general level of interest rates on the disposal of fixed income securities. These gains and losses are amortized to income, using the grouped method, over the approximate remaining periods to maturity of the securities sold. The amortization is based on groupings of gains and losses in five-year bands, according to the number of calendar years to expected maturity, and has not changed from the previous year.

MSC LIFE INSURANCE COMPANY

ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

Jerry L. Epler CPA/ABV, Examiner-in-Charge, and Keith D. Henderson CPA, CFE, Financial Examiner, from the Washington State Office of Insurance Commissioner, participated in the examination and the preparation of this report.

AFFIDAVIT OF EXAMINER IN CHARGE

STATE OF WASHINGTON)

) ss

COUNTY OF KING)

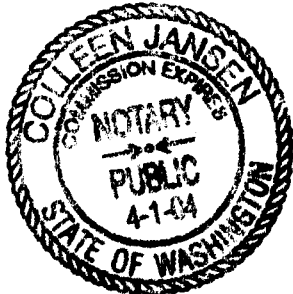
I, Jerry L. Epler, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

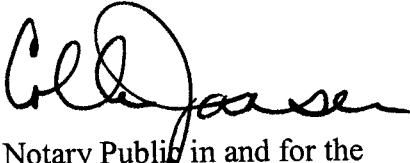
He attests that the examination of MSC Life Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner (OIC) and the National Association of Insurance Commissioners (NAIC).



Jerry L. Epler, CPA/ABV

Subscribed and sworn to before me on this 25th day of August, 2003.




Notary Public in and for the
State of Washington, residing
at Seattle.
My commission expires 4/1/04.